Deficit Reduction Measure Ushers in Tax Cuts Plus New Aid for Low-Income Populations in 1998

New tax cuts should encourage various activities, such as savings and investment, higher education, support for families, and environmental cleanup. Most new spending assists poor children and welfare populations, restoring some of last year's welfare program cuts. Although some new initiatives and tax breaks support development activities, most development program funding was steady or increased slightly. Meanwhile, the USDA Rural Development Mission Area and the Federal regulatory environment continue to evolve with important implications for rural America.

This Federal Programs issue of *Rural Conditions and Trends* (*RCaT*) describes Federal program and policy changes important for rural development, including most of the larger core development programs that assist rural infrastructure, housing, businesses, and general development (including planning and technical assistance), plus changes in tax and regulatory policy affecting rural areas. This issue examines budget, tax, and regulatory changes initiated in 1997 and taking effect in 1998. We also have two special articles: one covering the latest changes in welfare-related programs and the other describing USDA's evolving rural development mission.

Like other issues of *RCaT*, our analysis is primarily descriptive. In many of our maps and figures, we use the Census Bureau's Consolidated Federal Funds Reports data (also known as Federal Funds data) to reveal where individual Federal program allocations went in fiscal year 1996 (the latest available data), on the assumption that many of these same places will be affected by current policy changes affecting these same programs. We use various State and county typologies so we can describe how policy changes might affect specific types of places, such as farm States or poverty counties. A table showing the overall urban-rural distribution of major programs is presented in appendix A. Data sources and typologies are discussed in appendix B.

We are limited in the number of maps and other figures we can provide for any one issue, but over time we hope to present information on a wide variety of programs important to rural development. In earlier issues—particularly our first Federal Programs issue (Vol. 7, No. 2)—we covered a wider array of programs, including agriculture, health, defense, education, employment and training, environment and natural resources, and income support programs.

Some Major Themes of This Report Flow From the Deficit Reduction Legislation

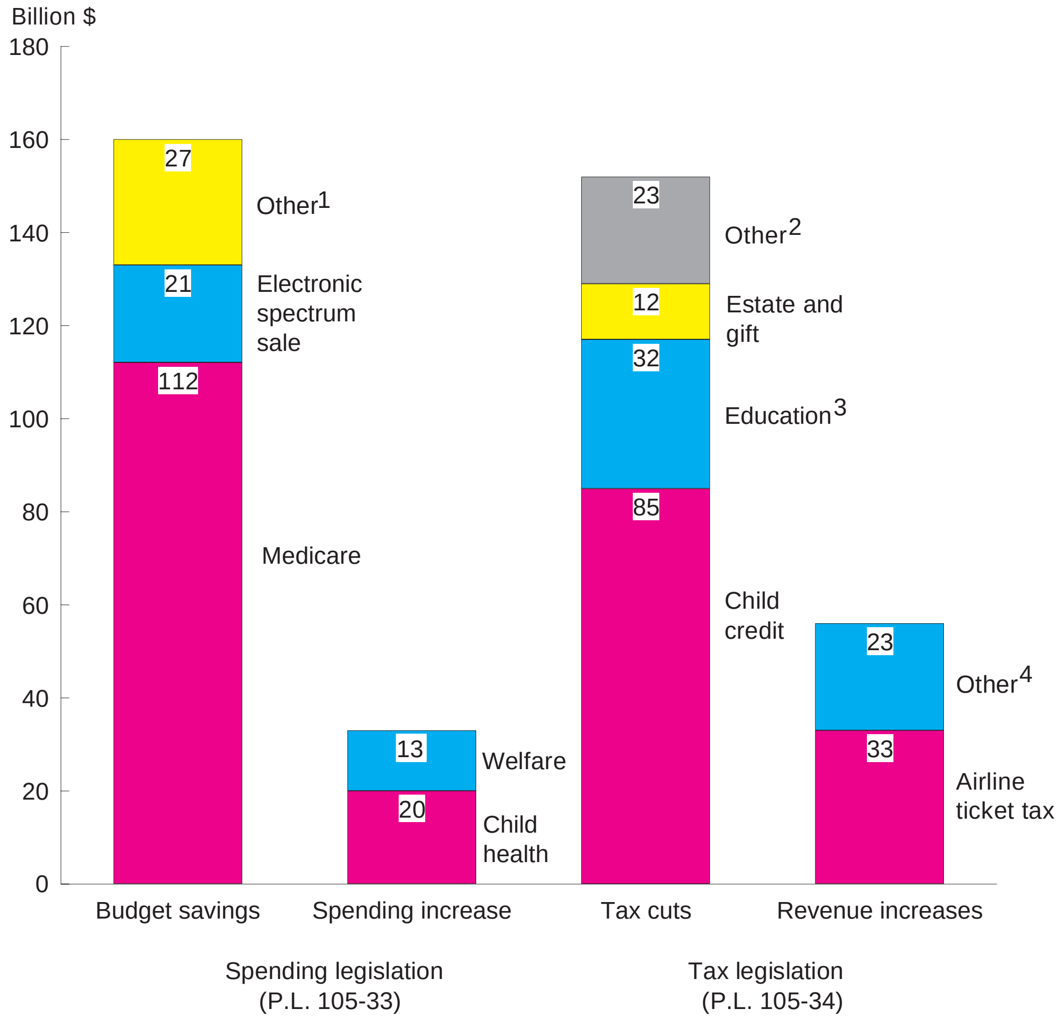
While charting a course to balance the budget, Congress and the Administration jointly found a way to cut taxes as well as increase spending. The deficit reduction legislation enacted in the summer of 1997 reconciled tax and spending plans with the resolution to balance the budget by the year 2002 (unless otherwise indicated, years cited in this article refer to Federal fiscal years, which begin October 1 of the previous year). Most of the anticipated deficit reduction derives from the assumption that economic growth will continue unabated, and from reduced growth in Medicare payments to hospitals and other health providers. Additional budget savings will come from Medicaid cuts, auctions of the electromagnetic spectrum, and revenues from the new segmented airplane ticket tax (which exempts flight segments to isolated rural airports) and from an increase in the cigarette tax. As a result, it was possible to actually increase Federal spending by $33 billion on programs mostly benefiting low-income children and welfare populations, while providing some $152 billion in new tax cuts over the coming 5 years (fig.1).

Although some rural development-related initiatives got a big boost from this legislation—particularly the welfare-to-work initiative—the 5-year budget plan allows little more than a 1-percent-per-year increase for most domestic discretionary programs, below that needed to keep up with expected inflation. Unless the economy performs better than anticipated or new sources of funds can be found, most of the major development programs appear to be facing stagnant funding levels in 1998 and in the coming 5 years. After the year 2002, more difficult budgetary adjustments may be needed as the cost of recently enacted tax reductions mounts. Another long-term concern involves the coming retirement of the baby boom generation, expected to cause rapid growth in the cost of Medicare and Social Security programs. The 1997 budget legislation accomplished no fundamental program changes to address this baby boom issue.

Figure 1

5-year changes in spending and taxes from the 1997 deficit reduction legislation

Deficit reduction was achieved through two pieces of legislation, one affecting mainly spending programs, the other affecting taxes



[1] Includes savings from Medicaid, cigarette tax increases, and miscellaneous spending cuts or tax increases.
[2] Includes new IRA's, capital gains, and other tax reductions.
[3] Includes only the hope and lifetime learning credits, excludes other, generally smaller education tax cuts.
[4] Includes extension of Federal unemployment surtax and miscellaneous revenue increases.

Source: ERS compilation, based on data from the Congressional Quarterly Weekly Report.

While long-term issues remain unresolved, the situation for rural development policy seems to have improved from 1 or 2 years ago. Among the most important development-related provisions to be implemented in 1998 are (1) the new tax cuts, some of which are targeted to development activities, (2) the creation of a new welfare-to-work grant program and the restoration of some welfare benefits that were cut in 1996, (3) the creation of a new State Child Health Insurance Program (SCHIP)—a block grant to address the needs of low-income children who lack health insurance, and (4) changes in Medicare and Medicaid programs that finance health services for the elderly, disabled, and low-income populations.

The changes affecting Medicare and Medicaid deserve note for their potentially disproportionate effects on rural areas. For example, the deficit reduction law significantly increases the minimum payment to managed care providers to $367 per month per beneficiary, resulting in narrower urban-rural differentials in plan payment rates. This should attract more health plans into rural markets, giving more residents access to managed care service that is preferable to fee-for-service for some kinds of health sevices. Because the new law did not increase payments for fee-for-service care, however, this could be a disadvantage for providers and beneficiaries who remain outside of managed care plans. Other significant health-related changes include (1) rising Medicare part-B premiums without compensatory increases in subsidies to low-income elderly beneficiaries, which over time could be problematic for the poor elderly that are more common in rural than urban areas; (2) increased State control over Medicaid, including the ability to cut Medicaid payment rates and end subsidies of Medicare out-of-pocket costs for low-income recipients, which some experts believe might hurt health care access for the poor; and (3) expanded coverage of benefits, including preventive health care and cancer screening, which would particularly benefit rural areas because of their relatively high proportions of elderly and disabled.

The new SCHIP child health insurance program is authorized to spend $20 billion over 5 years, the largest new program in the budget. It could particularly benefit rural communities because they tend to have a higher share of uninsured children than urban communities, but States have considerable flexibility in how the new child health money is used, so it is difficult to say exactly how this program will affect rural areas at this time.

Although these health program changes are important, in this report we focus on the tax- and welfare-related changes, including the new welfare-to-work program, because they are more closely associated and coordinated with rural development programs and strategies.

Tax Reduction Will Benefit Rural Areas

The Tax Relief Act of 1997 reduces taxes for various types of individuals and economic activities, potentially affecting all rural America. It includes tax relief for families (child tax credit and education tax incentives), incentives for savings and investments (individual retirement accounts and capital gains tax breaks) and various forms of tax relief for farmers and businesses (self-employed health insurance deduction, alternative minimum tax rate for small corporations, and capital gains, estate and gift tax reductions, and special tax provisions targeted to farmers).   Although most of the tax savings benefit primarily middle-income people and places, some new tax cuts focus on problems of low-income people and places, including incentives to hire employees from targeted groups of disadvantaged individuals or places (work opportunity and welfare-to-work tax credits) or to encourage private enterprise development in high-poverty or distressed areas (new Empowerment Zones, Brownfields).

Welfare-Related Program Changes Also Significant

Besides the new welfare-to-work tax credit, a variety of program changes have occurred that should help welfare populations in adjusting to the welfare reform enacted in 1996. The most significant change was the creation of the new welfare-to-work block grant program providing $3 billion during 1998-99. This program includes both a formula grant to the States and competitive grants directly to local communities. Other welfare-related changes include the restoration of Supplemental Security Income (SSI) benefits to legal immigrants who were residents as of August 22,1996, and Medicaid coverage for disabled children who might have lost coverage because of welfare reform.   States may now exempt some able-bodied food stamp recipients from work requirements.   In addition, Job Training Partnership Act programs got funding increases, which should help with the training part of the welfare-to-work program.

Other Themes Involve General Assistance Initiatives, Increased Infrastructure Aid, Emphases on Small Business and Homeownership, and Regulatory Changes

The main general assistance programs (programs that provide multiple forms of development assistance) are minimally changed in 1998, but many of the smaller programs are getting funding increases, and several new multi-agency initiatives are expanding, including Empowerment Zones, Brownfields, and Community Development Financial Institutions. These expanding initiatives assist high-poverty urban and rural areas.

Highway aid, the Nation's largest infrastructure program, increases by 11 percent in 1998, with more substantial changes expected when the program is reauthorized. Some smaller transportation-related programs have also been given a boost, including the Appalachian Development Highway System, Amtrak, and the Airport Improvement program. The Essential Air Services program, which particularly assists small towns and rural areas, was given a larger and more stable revenue stream. Except for the water and waste disposal program, USDA's infrastructure programs are expected to increase their assistance in 1998, with the largest increases in telecommunications and community facilities.

Some business assistance programs, including USDA's Business and Industry program, are increasing their assistance levels in 1998. The Small Business Administration's Section 7(a) program, the Nation's largest business assistance program, is also expected to increase its loan guarantees, consistent with the recent Federal emphasis on stimulating development through small and minority business development. The larger business assistance programs continue to reinvent themselves to better serve nontraditional borrowers, while achieving efficiencies through greater use of private sector lenders to screen and monitor loan performance.

Housing assistance programs increasingly emphasize homeownership as more Americans are expected to buy their own homes. Homeownership program activity is expected to increase in 1998, as mortgage financing is made more available to those who would otherwise be unlikely to purchase a home. Families targeted for assistance include minorities and low-income individuals, which are now the populations with the most rapid homeownership gains. Public housing and rental assistance expenditures are fairly stable, but significant changes are expected soon for these programs.

The most significant regulatory changes involve telecommunications, electric power, pollution controls, public land management, and financial institutions. The telecommunications industry is going through turbulent adjustments to changes arising from the Telecommunications Act of 1996. New, more restrictive, air and water pollution regulations have been proposed which, over time, could significantly affect development in many rural and urban areas. New plans have been proposed for more effective management of natural resources on national forests and public rangeland in many parts of the country, and legislation was enacted to clarify and amend the mission of the National Wildlife Refuge System, recognizing both the interests of resource conservation as well as recreation on the 92 million acres of refuge areas nationwide. Meanwhile, regulations covering financial institutions, such as banks, credit unions, and the Farm Credit System, continue to evolve, with some significant implications for rural areas.

This Issue Highlights the USDA Rural Development Mission

USDA has primary responsibility for planning and coordinating Federal rural development efforts. It also operates most of the programs that target assistance in rural areas. The lead USDA entity for rural development is the Rural Development Mission Area. In earlier issues of *RCaT*, we mentioned some of the changes underway in this Mission and we have covered in some detail how some of its main programs are being reinvented. However, our coverage of this mission area has been fragmented due to the organization of our report into separate types of assistance, such as infrastructure, business, and housing assistance. In this issue, in addition to our normal coverage of these programs, we provide a brief, comprehensive, description of this rural development agency's organization and programs, both large and small, including recent initiatives. *[Rick Reeder, 202-694-5360, rreeder@econ.ag.gov]*